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CONTRIBUTIONS

Valeriu Prohnițchi
Alex Oprunenco
Alexandru Gamanjii
Ana Popa

EXPERT-GRUP

web: www.expert-grup.org
email: info@expert-grup.org
address: MD-2068, Republic of Moldova
Chisinau, 1, A. Russo str., 1office 804
tel./fax: /37322/ 43-82-80
tel. /37322/ 43-82-45, 81-51-47

Summary

There were few significant events registered in September concerning the evolution of the **legal framework**. The new law for preventing and fighting money laundering and financing terrorism stipulates that several reporting bodies should monitor attentively occurring transactions and inform corresponding authorities about suspicious economic partners. According to the new Energy Strategy privatization in this area will continue, while the law for state property administration and public property denationalization does not include energy facilities on the list of property subject to privatization. In September the government adopted the Wine Sector Development Concept by means of credit instruments. This measure carries social rather than economic character.

In August the monthly **industrial growth** was close to zero, which offsets the results registered in June-July. Mining industry indicators became less remarkable, mainly due to the property disputes at the Cosauti mine. Economic growth in tobacco, textile, wood and timber processing, machine construction industries is at halt. This stagnation is compensated by the economic growth registered in the meat processing industry. Dairy and canned food industries preserved the positive trend. However producers in these branches already face the rising prices for and the deficit of raw materials.

In the **agricultural sector** the yield of harvested crops is 30-50% smaller than the previous year. Central authorities are taking measures for replenishing national reserves of forage grain and promote farm land consolidation initiative in the framework of a new strategic document to be issued concerning agricultural reforms, proposed earlier by the National Forum of Agribusiness.

The registered positive dynamics in the **service sector** is due to the rising volume of paid services for population, increasing volume of cargo and air, rail passenger transportation and retail trade. Internet and Informational Technologies lag behind development tempo.

The growth of **prices** continued in September (+1,6% compared to august 2007). The cumulative inflation level, already reached the 9% mark, which dismisses any hope of the government to keep it under 10%. National Bank of Moldova has adopted new measures for controlling price dynamics, by increasing the interest rate to 16%.

Evolutions registered on the **labor market** reflect the constant rise of salaries. However this does not redress the high risk associated with the loss of qualified labor and constant increase of prices for food and energy. Central authorities and private companies keep seeking tools for optimizing employees' motivation, by improving the law of remuneration, by allocating living places for employees and instruments for their professional development.

While during January-September, the revenues of the **state budget** equaled 101.7% of the forecasted level, expenses were around 89.5%. The key financial laws for 2008: (1) state budget law, (2) state social insurance law and (3) mandatory medical insurance funds, were adopted by the government and passed for examination to the Parliament. The state budget revenues are forecasted to be MDL 14658 million and expenses - MDL 14881.7 million. The biggest share of state budget is allocated for implementing the law on salary. As a result of the "0" taxation on the reinvested profit of the economic agents, the transfers from the state to local budgets will increase by approximately 55% in 2008. Even though higher transfers seem to compensate the losses of the local budgets, this measure appears to weaken the financial autonomy of the local authorities.

Important changes took place in the **monetary policy**. The National Bank of Moldova administration board, decided at the end of September to increase the interest rate on issued credits by the bank from 13.5% to 16%. This is the sharpest increase for the past 7 years. The last time when the interest rate was quoted at 16% was in September 2001. In spite of these measures, it is less likely that consumer price index will have a growing rate within the limits set by the National Bank of Moldova. The factors which contributed to the inflation burst in July – September 2007 are – the strong money inflows and the rising level of consumption demand, which is financed through bank credits. It is forecasted that these factors will not disappear in the near future. On the other hand, despite the growing money inflows, in the relative terms the current account balance is worsening. In future the monetary flows may not compensate the strong pressure on Moldovan leu, which in the long term can depreciate against the US dollar.

In August, the average interest rate for **bank** deposits in national currency was decreased to 14.99%. In the meantime the interest rate for credits issued in national currency achieved its highest value in the past 2 years – 19.06%. Commercial banks have not reacted yet to the



changes introduced by the National Bank of Moldova. In September the privatization of the “Banca de Economii” was brought to a stop. „Deloitte & Touche”, the winning company for evaluating the market value of the bank, is willing to take part in the privatization of the bank. In this conflict of interests, the Ministry of Finance intends to review the results of the bid and announce the name of the company which will evaluate the market value of the bank in October of this year.

In September, the interest rate for state securities kept declining. However as a result of a growing inflation rate, investors decided to review their strategies, showing clear decreasing interest for state securities. In order to preserve the placements, National Bank of Moldova and Ministry of Finance had to increase the interest rates paid to the holders. In particular, during the bid which took place on October 2, the nominal rate for BT-91 was 13.60% (against 11.20% at the last session in September) while on October 9 it was already 15.45%.

In the first eight months the **trade deficit** reached \$1.4bn. Though moderate, on the background of wine embargo, exports registered a significant growth. Following a new declaration concerning Moldovan wine exports, companies may soon resume the exports of wines and wine products to Russia. The access to the Russian wine market will be granted only to short listed wineries by the corresponding authorities.

In August prices for Brent crude **oil** reached \$80/barrel. This was caused by a reduction in oil reserves and its derivatives in the US, unfavorable weather conditions in the Gulf of Mexico and explosions at refining facilities in Mexico. OPEC's decision to increase the daily oil extraction quota by 500mln of barrels could not slow down the growth.

The forecasts for **grain** harvest for 07/08 were revised down in September because of the poor harvest in Australia. Thus, the global reserves of grain are the lowest in the past 34 years. Meanwhile, the rising dynamics for grain prices stimulates farmers to increase their grain plantation areas next year.

In September, the **dollar** exchange rate was continuously sliding down against **euro**. The weakening of the dollar is caused by the economic difficulties America is facing and the expectations for the FED to decrease the interest rate. Thus, by the end of the month, the exchange rate fluctuated in the 1.40-1.42 dollars margin per euro.

Russian economy continues to grow: +7.9% in January-August 2007. As in the past, factors which fuel the economic growth are demand for investments,

constructions and industry. Important evolutions were registered in the political area. Vladimir Putin became the head of the „Edinaia Rossia” political party. It means that he intends to continue playing a major role in politics after the presidential mandate expires. In the short term, this will have a positive economic impact. Future perspectives will depend on whether the central power will be able to promote reforms in a less competitive political environment.

Ukrainian economy continues to expand, due to growing private consumption and exports. In the coming years investments will become the key factor which will contribute to the economic growth. The Ukrainian parliament elections did not determine a key winner. Currently the most probable option which can be applied is to restore the “orange” coalition. Even this measure cannot guarantee a sustainable path to reforms.

European economy is reviving, after a recent slow down. Strong consumption demand and investments together with foreign demands for European exports continue to be the key factors to fuel this growth. The growing economic surplus indicates that a strong Euro did not harm the competitiveness of the European exports yet. Trade surplus of the Euro zone reached €4.6bn in July 2007.

In **Romania** the economy continues to grow actively. In the second quarter it grew by 5.6%. These tendencies are due to strong evolutions in constructions (+33.3% against January-August 2007) and trade (+33.3%). Industry is growing at smaller rate. The International Monetary Fund gave notice to the Executive from Bucharest about potential risks which can tarnish the economic grow perspectives in this country.



Legal Framework

In September there were few changes concerning the legal framework evolution. Partly this is due to holiday that the members of the Parliament and governmental officials went on. However some laws were discussed in this period. The new law for preventing and fighting money laundering and financing terrorism was published in the "Monitorul Oficial" of Republic of Moldova nr. 141-145, from September 7, 2007. The law determines a list of *reporting bodies* which have to inform the corresponding authorities about suspicious transactions and take measures for identifying juridical or physical entities involved in these transactions. However the monitoring of such transactions touches upon the economic interests of private companies and is less likely that these provisions will help combating money laundering.

The decision concerning Energy Strategy of Republic of Moldova to 2020 was published in the same issue of "Monitorul Oficial". Taking into account that the document was thoroughly elaborated, the Strategy contains aspects which raise questions. Firstly, the results of the previous strategy were not evaluated, even though its term hasn't expired yet (previous Energy Strategy was approved for period until 2010). Secondly, according to the strategy the state owned distribution networks (RED Nord and RED Nord-Vest), and three energy generating plants (CET-1 and CET-2 Chisinau, and CET-Nord Balti) will go private. However, the law for state property administration and public property denationalization does not have these energy facilities on the list of property subject to privatization¹.

On September 19, the government adopted the decision concerning incentives for the development of the wine sector using mortgage instruments². Analysis reveals that this initiative bears a social context (for supporting wine-growers), rather than an economic justification. In order to consolidate the competitive factors of the wine sector in Republic of Moldova, a vertical integration of the wine growing and production capacities should be encouraged. Those wineries which can secure this vertical integration on their own will not require credits for planting new vineyards.

¹ Law of Republic of Moldova nr.121 from May 04, 2007, published in the "Monitorul Oficial" Nr. 90-93.

² Government Decision nr.1040, September 19, 2007.

Industry and constructions

In August, the monthly industrial growth was close to zero which offsets the accumulated progress in the first two summer months. While in June and July 2007 global production grew by 5% comparing to the same period in 2006, in August this growth registered only 0.5%. As a consequence the cumulative industrial growth in the first eight months of the year remained 0.4%.

The decline registered in the industry was determined by several factors. A slowdown is observed in the mining industry, which is determined by the property disputes at the Cosauti mine. The outcome of it is the temporary shut down of the mine. The tobacco industry continues to be weak because of the management problems at Tutun CTC and producers' inability to compete with import merchandise. Similar factors explain the recession in the clothes industry. However in the mid term (1-2 years) a robust growth can be expected. Wood processing industry is undergoing through a recession which lasts years in a row. In 2005, the decline rate was 14%, while in 2006 the growth was -4%. This dynamics has aggravated in 2007. In the first eight months of the year industrial production fell by another 19%. Heavy machines and equipment industry continues to face a negative growth (production decrease -8%). Metal manufacture went down by 12%.

Several branches of the food industry compensate the performance of the weak branches. Production of soft drinks and meat went up by 37% and consequently 27%. The increased output of soft drinks was due to the high summer temperatures. Summer drought forced livestock owners to slaughter cattle for meat, which increased meat supply to the market. In the first eight months, the dairy and canned food production had a positive dynamics. However, starting with September, producers had to face rising prices for raw materials as well as shortage of raw materials. It is believed that statistical data for September will reflect a decline in dairy output and a moderate growth of canned food output.

Agriculture

September brought about complex evolutions in agriculture. On one hand there were favorable climate conditions for planting crops and plowing the land. On the other hand the drought had a negative impact on crop harvesting. The harvest of vegetables was 33% smaller than previous year (65 th tons compared to 97 th tons). The disaster touched on



sunflower seeds harvest also. The average sunflower seeds productivity was 7 quintals/ha – which is twice less than in 2006 and the lowest productivity in the past 60 years. Sugar beet producers expect to harvest 50% less than in the previous year (approximately 600 th tons compared to 1.1 mil. tons). It is projected that sugar output will decrease by 50-54% compared to 2007 (circa 80 th tons compared to 150 th tons). Sugar producers hope that internal demand will be entirely met.

Prices for autumn crops grew significantly compared to September 2006. Therefore, prices for tomatoes range between 12-16 Lei/kg, sunflower oil– 23 Lei/l, up by 20-25% and respectively up by 40-44% compared to last year. Prices in sugar procurement contracts for this year fluctuate around 380 USD/t. In the near future sugar quotations can be revised down to 280 USD/t on because of the strong sugar harvest in EU, India and Brazil.

The grain deficit in the reserve consists 20 th tons. Regardless of the fact that the government announced 3 consecutive procurement bids in July, August and September, only 3,925 tons of grains were purchased in the first two bids. During the last bid national suppliers were offering grain at 3,987 Lei/ton and Lithuanian suppliers at 3,356 Lei/ton, which exceeds government's benchmark price 2600-2800 Lei/ton. Thus, according to the law concerning state procurements, the National Agency for Public Procurements was entitled to conduct direct negotiations with potential bidders from Kazakhstan. In the meantime, the Ministry of Foreign Affairs and European Integration was appointed to negotiate with suppliers from Romania and Russian Federation. Grain procurement difficulties relate to national producers' expectations regarding local and regional grain market evolutions, as well as potential grain export restrictions in Russia and Ukraine. This can reduce the number of potential bidders. Meanwhile, if the national reserves will be supplemented from these countries, then restrictions can be eliminated, which will facilitate grain import to Moldova.

In order to find solutions for the agricultural sector, the government adopted recently the Land Consolidation Regulation, according to which up to 40% of individually owned lands will be consolidated (3mln. parcels). This measure will cost the state budget and other international donors approximately 200mln. Lei. The decision to adopt the regulation is the result of discussions held in 2005³. The

³ National Conference „Farm land consolidation– first measure for increasing investments in agriculture!”, organized on 08.07.2005 by the

recommendations resulted from these talks had to be applied when elaborating the National Plan for Farm Land Consolidation. An essential condition for implementing these programs is simplifying the procedures for registering the transaction with land. Unfortunately these provisions progress slowly, because of the reduced purchasing power of the farmers and lack of credit programs for this purpose. Meanwhile, when consolidating the lands, it has to be taken into account that Moldova's agricultural competitive advantage is based on growing crops with a high value added – fruits, vegetables and fresh, frozen or processed grapes.

Services

In January-August the volume of services increased in real terms by 5.4% compared to similar period in 2006. About 42% of services were offered by public entities (up by 1.8% compared to January-August 2006), 33% - by private agents (+17%) and 25.4% - by mixed entities (-2.9%). During this period the volume of freight transportation increased by 11.1%, reaching 10.7mln tons. Rail and air passenger transport increased by 6.1% and consequently by 5.9%. The number of passengers transported by busses decreased by 7.8%⁴.

As a result, the share of serviced in GDP reached 65.1%, which is 2.8% more than in January-August 2006. The immediate cause for this growth is the rising consumption demand and purchasing power of the population.

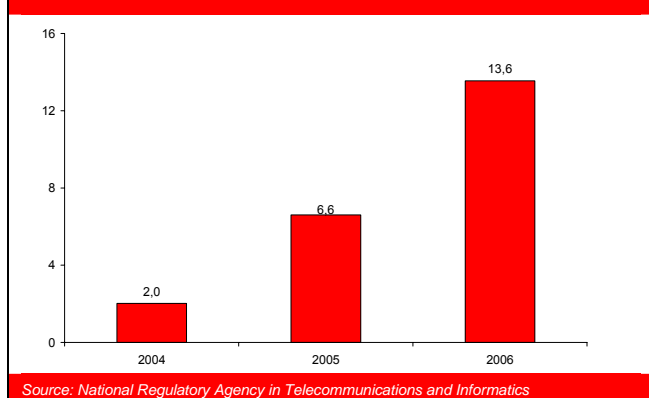
The volume of retail sales increased by 11.7% as compared to January - August 2006. Around 70% of these sales come from private companies (up by 13.4% than in January - August 2006), and 24.5% - to companies with property type with foreign capital (+11.6%).

According to a national public opinion survey, 84.7% of respondents consider that internet services lag behind the rapid growth of the mobile communication market⁵. These figures are confirmed by the internet access penetration rates registered 2004-2006 (Figure 1).

Ministry of Agriculture and Food Industry in cooperation with the Project for Supporting Land Privatization (LPSP) funded by the United State Agency for International Development (USAID)

⁴ Freight and passenger transport in January-August 2007, NBS.

⁵ Public opinion survey „Republic of Moldova 2007: state of the country and its people”, conducted in august 2007 by Center for Sociological and Marketing Investigations CBS AXA on request of the Expert-Grup think-tank.

Figure 1 Total Internet access penetration rate, %

In 2004-2006 this penetration rate increased 6.7 times, partly because of the small basis in 2004. Having in mind the structural aspect, Internet services can afford private companies or segment of population with higher than average incomes. From the qualitative point of view, the majority of users prefer dial-up connection. Even though dial up is underperforming broad band, creates technical inconveniences and has a navigation speed limit, it is more affordable than other alternatives.

Prices

Prices continued to grow in September (up by 1.6% than in august). The cumulative inflation for 2007, has already reached 9%, dissipating the hopes of the central authorities to keep it under 10%. The cumulative inflation for the past 12 months was 14%. The National Bank of Moldova is concerned for the rapid grow of prices and took serious measures by increasing the interest rate on credits by 2.5 p.p. in September.

Table 1. Monthly inflation rates, %

	June 2007	July 2007	August 2007	September 2007
Consumer price index	0,0	1,1	2,2	1,6
Food products	-1,3	1,6	2,2	1,6
Non-food products	0,7	1,1	0,9	1,5
Services	0,2	0,4	5,2	1,6
Industrial product price index	0,0	0,8	1,2	

Source: National Bureau of Statistics

Prices for food and services went up by 1.6%, while prices for non-food products increased by 1.5% compared to august. While fruits, milk and dairy

products are 4.0% and 3.5% more expensive, the prices for vegetables went down. In the group of non-food products, prices continued to grow for medicines (+4%). From the beginning of the year, they went up by 16.1%. Prices for garments increased by 1,6% and footwear by 1,4%. Prices for passenger transport gained another 1.8% (including 6% for urban transportation) and public utility services went up by 1.1%. In the meantime, industrial product price index in August grew by 1.2% compared to the previous month.

Labor market

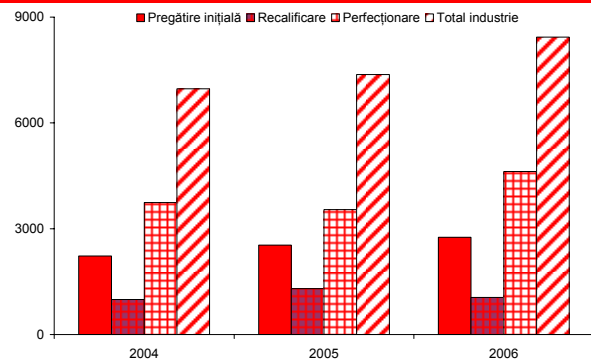
In January-August 2007 the real salary in the economy increased by 9% compared to the previous year. Average monthly salary grew by 22%. In August 2007, its value was 2131 Lei, which is 21% more than in August 2006 and 0.6% less than in July 2007. This was caused by 11.7% decrease of the nominal budgetary salary (1563 Lei) and the increase of the salary in the real sector (2407 Lei). Therefore, real sector salaries register significant growth every month. In July-August 2007 real salaries increased by 7.48% than in June. This growth is the outcome of economic evolutions, characterized by improvement of employees' remuneration in conditions of elevated risks for abandoning the working place and emigrating abroad. Another reason is the weak purchasing power of the nominal salary and price increase for the basic need products (eggs, milk, cooking oil etc.) and energy. This tendency will continue to reduce the volume of goods and services which can be purchased with the nominal salary. Many emigrants state that having an equal sum of money, same volume of food can be purchased in Chisinau and Paris. In this context, improving labor remuneration will be the target issue in the mid and long term for the local companies.

Recently Ministry for Economy and Trade suggested modifying the Law concerning labor remuneration from 14.02.2002. It will give employers the right to select a suitable remuneration plan, by introducing tariff-based and combined systems, which should help raising employees' interest for the final result. The first system determines the company to negotiate the salary with branch authorities. The second system will help stimulating employees by measuring their productivity, product and delivered services quality. As a result it is expected that skilled workers will earn higher salaries. We consider this law will guarantee a minimal salary in the real sector. In future the companies will be able to choose which system to apply or combine both. At the same time,



having this law, labor productivity can outrun the salary growth rate. It is still unclear to what extent higher labor productivity will reflect the correlation between remuneration level and employees' expectations. This goal will require taking transparent measures to inform the employees about the mechanisms and explain about potential amount of the salary.

Figure 2 Number of companies investing in professional training



Surse: NBS

Another efficient instrument for motivating and retaining employees was proposed by the Association of Light Industries. It is suggested to offer employees resources for purchasing a living place. For this purpose, the association decided to elaborate a national program, funded by the state, various companies and employees themselves. These measures result from the deficit of qualified labor force. Light industry companies having signed contracts with EU countries and being on the list of top country exporters, are now facing the deficit of qualified labor.

In this context, national companies have increased their interest for professional development of their employees (Figure 2). In 2004-2006 the number of employees trained within the surveyed companies raised by 17.34%. 6970 employees were trained in 2004, 7375 – in 2005 and 8433 – in 2006. We consider that large companies will pay closer to this issue. For securing the necessary body of qualified employees, these measures will increase the labor costs by circa 17-20%.

The budget

The state budget revenues constitute MDL 9523.3mln. as of September 30, which is 1.7% more than it was forecasted for this period. Budget expenditures totaled 9793.5mln. lei – which is 89.5%

of the planned amount. In January-August 2007, the national public budget was executed at 103.6%. The main source of the surplus is the tax on revenues accumulated from entrepreneurial activity. The volume of expenses was 86% from the projected amount.

Table 2. National public budget dynamics, millions MDL

	Planned L1-L8/07	Executed L1-L8/07	Executed L1-L8/06
Global revenues	12879,5	13346,3	10742,9
including, revenues from TVA,	4572,5	4573,3	3619,3
Including, tax on revenues from entrepreneurial activity	752,3	953,0	950,7
Global expenditures	15778,6	13562,4	10698,1

Surse: BNS (National Bureau of Statistics)

On September 26, the Government has approved the drafts of the most important financial laws for 2008: the draft law on state budget for 2008, on social security fund, and on the mandatory medical insurance fund, all of which are already being discussed in the Parliament. State budget revenues are expected to be 14658 mil Lei, and the expenses 14881.7 mil Lei. The drafts are based on a 6% GDP growth as opposed to the 7% figure proposed in the draft version of the Ministry of Finance; an inflation rate of 9.3 % and an average annual exchange rate of the national currency of 12.2 Lei for 1 US dollar.

The largest share of expense in the state budget for the 2008 year – 1072.2 mil Lei is allocated for implementing the Law on salaries. The social expenses detain 68.4% from the national public budget for 2008. The draft law on the social security has been approved with a 20 mil Lei smaller budget than it was initially proposed – 6256.7 mil Lei. The largest share of the expenses falls on the Pension Fund (4512 mil Lei). The revenues and expenses of the Mandatory Medical Insurance Fund have been calculated at 2622 mil Lei, which is 35% more than in 2007. This is the result of the price increase of the mandatory medical insurance policy to 1893.6 Lei in 2008, and the increase of the mandatory medical insurance premium by 6 %.

According to the research “Fiscal amnesty and the ‘0’ taxation on the profits of economic agents from Moldova: evaluating the impact and potential risks”⁶,

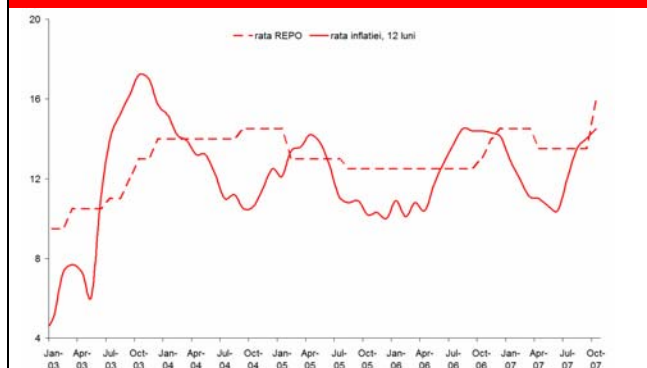
⁶ Valeriu Prohnițchi, Hardo Pajula, „Fiscal amnesty, capital legalization and “0” taxation of the economic agents’ reinvested profit”, research ordered by the Soros-Moldova Foundation, www.expert-grup.org.

the net losses that will result from the “0” taxation on the reinvested income of economic agents amounts approximately 810 mil MDL (1.5 % of the GDP). The most affected will be the local budgets. Thus, the transfers from the central to the local budgets will have to be increased. In the draft law of the state budget for 2008, it is estimated that the revenues of the local budgets will amount 2328.1 mil Lei, and the transfers from the central budget for leveling the disparity will equal 2721.1 mil Lei. This is 55.3% more than in 2007 and this instrument obviously will greatly diminish the financial autonomy of local authorities.

Money

In the previous edition (BER 23) we have anticipated that NBM would slightly increase the basic interest rate, as a result of the building inflationary pressures in the economy. In reality, it was more than a slight increase. At the NBM board meeting from September 26, it was decided to increase the interest rate for the REPO transactions from 13.5 % to 16.0%. This is the biggest interest rate increase for the past 7 years, when in 2001 the basic rate was 16%. This reveals the serious concern of the central bank which tries to maintain the inflation in the projected margins (8-10%). In addition to this, NBM has used another instrument – the level of mandatory reserves from the attracted funds in convertible foreign currencies will increase by 5 percents. It is not yet clear how gradually will increase the level of obligatory reserves.

Figure 3: The evolution of the annual inflation rate and the NBM basic interest rate, %



Source: NBM, forecasts for October EG

Despite these measures, the consumer price index is less likely to increase in the limits forecasted by NBM. The factors that determined the inflation boom in July-September 2007 will not disappear in the near

future. The inflows of foreign currency from the emigrants, foreign direct investments and the transfers within the bi- or multilateral official assistance programs have accelerated in the third quarter.

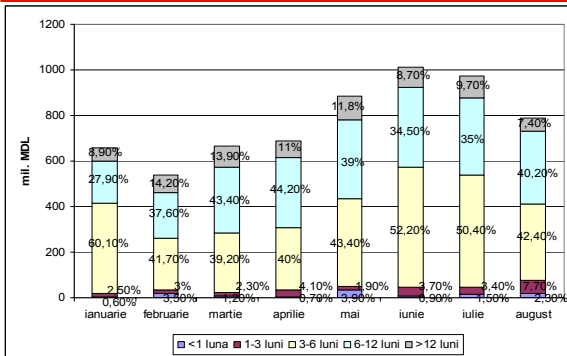
Furthermore, the 2007 year is marked by a stronger competition in the banking are as a result of foreign players coming to the bank market of the country. Competition becomes stronger as the banks improved their credit services for the population. Even if the interest rates did not necessarily decrease, other credit aspects draw attention (longer time periods, no collateral required, easies procedures, etc.). As a result the volume of credits issued for consumption purpose has increased in the first half of 2007 by 75%. This was another major factor that has fuelled inflation through a stronger demand. It is expected that it will persist and may have a stronger impact in the near future. It is evident that inflation structure should be studied in more details, but our conclusion is that in the short run NBM does not have enough tools to fight inflation, which will require the bank to diversify its portfolio. The major risk is that having a strong desire to control inflation by eliminating money from the circulation can result in a “shortage of liquidities”, which can have a severe impact on the economic system.

Banking System

In August the average interest rate on credits in national currency has increased to 19.06%, reaching the highest value for the past two years. The average interest rate on credits issued in foreign currency was 10.8%. The average interest rate for deposits in national currency was 14.99 % and 6.16 % in foreign currency. Commercial banks have not followed the NMB increase of the interest rate as it was expected. The volume of deposits in Lei has reduced substantially by approximately 19% compared to July, as a result of less deposits coming from natural persons. The share of long term deposits (6-12 months) has increased while the short term deposits (3-6 months) decreased volume. Same dynamics is characteristic to deposits for over 12 months. At the same time, deposits in foreign currency have substantially increased. They reached the historic value in August – 1062.9 mil Lei. The most frequent deposits are made for a 6-12 months period. (Figures 4 and 5)

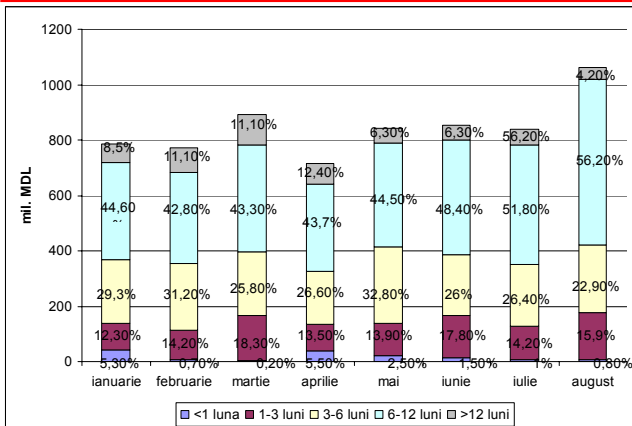


Figure 4: The structure of the deposits in MDL



Source: National Bank of Moldova

Figure 5: The structure of the deposits in foreign currency



Source: NBM (National Bank of Moldova)

The auction for selling the commercial bank "Unibank" took place on the September 24th. The Austrian investment group Vienna Capital Partners, being the only bidder, purchased the shares of "Unibank", which was previously owned by the Russian "Petrocomert" bank, preceded by Lukoil. The bidder purchased 610 thousand shares (100%) at 396.67 Lei per share, having 200 Lei/share nominal value. The volume of transaction was 241968.7 thousands Lei.

At the end of August the share of foreign investments in the capital structure of Moldovan banks has reached 65.32%. In the meantime, "Banca Transilvania", the biggest bank with Romanian capital, intends to examine the possibility to expand on the Moldovan market in 2008.

The privatization of "Banca de Economii", which is part of the Memorandum regarding the economic and

financial policies for 2007 signed between the Government of the Republic of Moldova and IMF, is temporarily blocked. "Deloitte and Touche" won the tender for the evaluating bank's market value of assets, and now intends to participate in the privatization. This conflict of interests may lead to under evaluating the value of "Banca de Economii", for purchasing it at a lower price. Also, in case this company will participate in privatization, it will obtain net advantages against other potential buyers that do not possess the information that can be obtained during the process of evaluating the bank. Privatization was stopped, and the IMF Head of Mission Graeeme Justice declared that this subject will be discussed during the IMF mission visit scheduled for the end of November. It has to be mentioned that "Deloitte and Tousse" has not signed the contract with the Ministry of Finance yet. The latter has the intention to revise results of the tender and select a company to evaluate market value of assets of "Banca de Economii" in October 2007.

Financial markets

Following the current year tendencies, in September the interest rates for the treasury bills continued to decrease. Thus, the treasury notes with the maturity period of 91 days (TN-91) were sold in September with a 10.55% interest rate, compared to 10.84% in August. However, the situation has changed dramatically during the first auction in October. Investors' demands for TN-91 and TN-182 was lower than supply from the Ministry of Finance. As a consequence preferences switched to TN-364. The growing inflation is the main factor that determined these banks' in this regard. As a result, banks were demanding higher interest rates for purchasing the treasury notes. On October 2nd, the nominal rate for TN-91 reached during the auction 13.60%, and on October 9 –15.45%.

Table 3: The dynamics of the current account of the Balance of Payments of the Republic of Moldova

	H1'03	H1'04	H1'05	H1'06	H1'07
Current account, million USD	+20,25	-24,3	-94,9	-179,8	-372,8
Current account, % of GDP	+2,6	-2,3	-7,4	-12,1	-19,7

In September the appreciation of the Moldovan leu against the US dollar accelerated. On the 1st of September the official exchange rate was 12.0789

MDL/USD. The rate changed on September 30th, when the USD was quoted at 11.5075 MDL. The exchange rate continued to fall, reaching 11.4793 MDL/USD on the 3rd of October 2007. The key factors that determine the national currency appreciation have not changed significantly: the inflow of foreign currency from the natural persons remains high and the foreign investments appears to have accelerated in the third quarter. According to the Balance of Payments for the first half of the year, the transfers from emigrants have reached \$95 mil, and the foreign direct investments – \$180 mil. If nothing changes, then in 2007 revenues from emigrants will reach \$1.5 billions, and the foreign direct investments – \$630 mil. As Russian ruble continues to appreciate against the American dollar it also contributed to Moldovan currency gaining value. On the other hand, despite the growing foreign currency inflows, in relative terms the current account has worsened (Table 3).

This can create in future strong pressures on the Moldovan leu that will not be able to be compensated by the inflows of foreign currency. In other words in the long run depreciation rather than appreciation of the national currency against the American dollar is more likely.

Foreign Trade

The data for August 2007 reflects the growing trade deficit. In January-August it reached \$1.4 billion, up by 42.6% than the similar period of the previous year. At the same time, the exports in this period reached only \$703.6 mil, growing by 16.3% compared to the last year. It is evident that the volume of imports covered by exports has reduced from 39.4% in January-August 2006 to 36.8% in the similar period of the current year.

In reality, if controlling for the losses from the Russian embargo on Moldovan wines (March 2006), exports registered a strong growth. In this case the export expansion rate doubled, which can not be interpreted as export “recovery” in 2007 having the embargo in effect. It is worth mentioning that even “food, beverages and tobacco” exports increased if effects of the embargo are eliminated. At the same time, the impact of this external shock will become noticed further in the dynamics of the Moldovan exports.

The imports continued to increase faster than exports: 33.8 % in January-August 2007 than in the same period of the previous year. An important share in the increase of imports is “Machinery and

mechanical appliances, electrical equipment” and “Basic metals and articles from basic metals”, which reflects a rising demand for these categories in the construction sector and overall industry.

Wine-makers were pleased to hear another declaration regarding resuming wine exports to the Russian Federation. As opposed to the previous declarations, it is possible that this time the exports will be resumed. According to the most optimistic estimations, a limited range of Moldovan wines will appear on the Russian market (mainly its European part) in the eve of the New Year. The pessimistic is also examined, as it is difficult to estimate the efficiency of the “one-window” system applied in Russia. Many producers express their concerns regarding this mechanism and quality tests conducted by Russian specialists. By the end Russian proposal about selecting wineries was accepted by the Moldovan authorities, which had to abandon the “all or none” principle. All that being said, it can be concluded that resuming wine exports will not solve the existent problems in the sector, and the contribution to the trade deficit will be limited.

Global markets

The month of September was featured by growing prices for oil. Several important factors influenced this dynamics: the reduction of stocks of oil and its derivatives in the United States, unfavorable weather conditions in the Gulf of Mexico, and explosions at the production capacities in Mexico. Prices kept growing after in the beginning of the month OPEC declared it will not raise extraction quotas. Even after it decided to increase the quotas by 500 thousand barrels per day, prices climbed from \$74/barrel (Brent crude) in the beginning of the month to \$77.8/barrel. At the end of the month prices were revised. However this was a technical adjustment of profits on the international stock exchanges. In the beginning of October the prices started to rise again, this time exceeding \$80. The majority of analysts consider this trend will continue in the near future. The Goldman Sachs agency reports that if prices fall over \$85/barrel before the end of 2007, then in 2008 prices will reach \$95/barrel⁷.

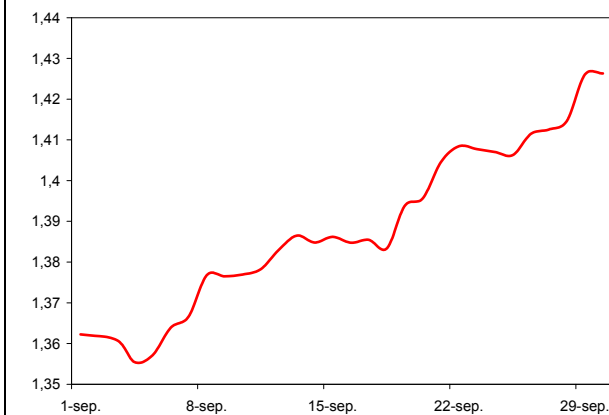
In 2007/2008 wheat harvest forecasts was downgraded to 601 mil tones because of the poor harvest prospects in Australia. The global consumption is estimated at 612 mil tones, and the global stocks have reached the lowest level in the

⁷ Source: The Economist, International Energy Agency, Reuters, RBC



last 34 years. At the same time, the price increase for wheat (+25 % only in the last month) stimulates many farmers to increase their wheat plantations in the next year. Prices for barley increased substantially also, because of the poor harvest prospects in Australia – the main supplier of barley on the global market⁸.

Figure 6: The evolution of the exchange rate euro/dollar



Source: Rossbusinessconsulting

The dollar depreciated strongly against Euro in September 2007 (Figure 6). In the first half of the month this trend was backed by statistical data about American labor market, disturbing news from real estate companies, and expectations that FED will lower the interest rates for stimulating the American economy. Yet, the reduction of the interest rates did not stop the dollar depreciation on the currency markets. This evolution has been strongly supported by other negative data concerning the American economy. Both consumer confidence index and the index of new contracts for manufactured goods have decreased. The exchange rate exceeded the psychological level of 1.4\$/€ and reached 1.42 \$/€. In the beginning of October exchange rate was adjusted after Jean-Claude Trichet, the president of the European Central Bank, spoke about the need for having a “strong” dollar. Adjustment took place in the context of low indexes which reflect the European economy (the index of processing industry, business confidence index in France). Yet, at the end of the first week of October, the dollar started to depreciate again reaching 1.41 \$/€. Dollar sliding continues to

⁸ Source: USDA, World Agricultural Supply and Demand Estimates, Wheat Outlook; International Grains Council, Grain Market Report; The Financial Times.

be determined by the difficult situation of the American economy⁹.

Trade partners

In January-August 2007 Russia has experienced a strong economic growth. Thus, in January-August 2007 the economic growth rate was equal to 7.9%, compared to the same period in 2006. As before, this growth was backed by a strong demand for investments goods (+22.1% in January-August 2007 than in the same period 2006), active expansion of the constructions sector (+24.4%) and of the industry (+7%). Industrial growth slowed in August, mainly due to a slow down in the processing industry. In July the industry expansion has been determined mainly by the growth in the investment demand driven sectors: constructions and machine manufacturing. Consumption started to fuel the economic growth due to higher disposable incomes of the population (+12.2%) outrunning of the real salaries (+16.7%). A strong consumption level generated growth of the retail trade (+14.7%). Exports dynamics is still moderate comparing to the last year indicators: 9.5% compared to 29.5%. On the contrary, the imports continued to increase by 37.5% in January-August, fuelled by consumption demand and investments, and not the least by a stronger ruble.

From a political point of view, a series of important events took place in Russia. First of all the Fradkov government was replaced by the Zubkov one. Apparently, the most important result of this restructuring was removing the unpopular minister of finance, Zurabov in the eve of the December parliamentary elections, and appointing a new minister of Economy and Trade. Secondly, president Putin accepted the invitation from the major party “Edinaya Rossia” to be on the top list during the parliamentary elections in 2007. Thus, it is obvious that Vladimir Putin will continue to play a major role in the Russian politics within many scenarios (prime-minister with consolidated decision power approved through constitutional changes, prime-minister in transition to the president chair if the newly elected president resigns for health issue, or speaker in the State Duma). In the short run these changes seem to have a positive effect on the economy by having predictable economic policies and avoiding a new property distribution. Nonetheless, it is more important to see whether the current party will be able to apply the necessary economic reforms, in the

⁹ Reuters, RBC, Global Insight Inc., OECD, The Financial Times.

framework of a strong political competition and little social mobility.¹⁰

In January-August 2007 the Ukrainian economy registered a +7.5% growing rate compared to the same period 2006. Consumption increased by +30.6 %, industry – +10.9% and constructions went up by +12.7%. In the next years it is expected that the role of the private consumption in the economic growth will decrease in favor of investments.

Despite favorable circumstances boosted exports by +31.9%, the trade deficit continues to aggravate, reaching \$5.25 billion in January-August 2007, with possibility to increase further due to pressure from imports.

The parliamentary elections that took place in Ukraine brought ambiguous results. The Regions party managed to accumulate a relative majority of the votes (34.37%, 174 seats in Verhovna Rada), while the “orange” party accumulated sufficient votes to create a government coalition with majority of votes in Rada – 248 seats out of 450 (BluT – 30.71%/156: NU-NS – 14.15%/72). Besides, the eventual “orange” coalition can join the Litvin block with 20 seats. The option of having a larger coalition, including the Regions party, is less probable – Iulia Timosenko declared that she will not joint such a coalition, but also some members from the NU-NS block who support president Iuscenko are against such an alliance. Thus, president Iuscenko can find himself in opposition with his own block. In such circumstances the awakening of the “orange” coalition seems to be the most probable solution. But this will not necessarily mean an easy cooperation among its members, mainly because both Victor Iuscenko and Iulia Timosenko have serious ambitions for becoming president in 2009 (the presidential elections are planned for December, 2009). Moreover, the chances for having decisive reforms are still low, because of the little time left before the presidential elections and absence of a common reforms agenda. Furthermore, the strong economic growth will continue to rise in the coming years, thus reducing the coalition incentives to speed up the reforms¹¹.

Tabel 4: The economic indicators of the main trade partners

¹⁰ Ministry of Economy and Commerce, The institute of the transition economy (Институт Экономики Переходного Периода).

¹¹ Institute for Economic Research and Policy Consulting (Інститут економічних досліджень), International Centre for Policy Studies (Міжнародний центр перспективних досліджень), Expert-Ukraine(Експерт-Україна).

of the Republic of Moldova

	GDP		Industrial output	Inflation	Unemployment rate
	Last data	2007, forecasts			
Russia	7,7 01-08/07	7,0	7,0 01-08/07	6,7 01-08/07	5,7 08/2007
Ukraine	7,5 01-08/07	7,5	10,9 01-08/07	6,2 01-07/07	7,1 T2/2007
Romania	5,8 T2/07	6,5	6,0 01-08/07	5,0 08/07	6,9 07/07
Germany	2,5 T2/07	2,2	5,3 07/07	2,0 08/07	6,3 08/07
Italy	1,8 T2/07	1,7	-0,1 06/07	1,7 08/07	5,9 T2, 2007

Source: The Economist, IMF, World Bank, Derjkomstat, Goskomstat, Eurostat, INS România, EXPERT-GRUP

Economic prospects in the **European Union** remain optimistic, though a slow down was recorded in the last months. At the same time, most analysts consider that the European economy will continue growing in future. It should be emphasized that export expansion continues, and trade surplus reached € 4.6 billion in July. This data reflects that a strong Euro did not harm the competitiveness of the main European exports. Another positive trend is the growing private consumption (+0.5%). This means that internal consumption can have a bigger contribution to the economic growth in the framework of a general recession of the American economy. In general, the prospects for the economic growth are positive for the rest of the year¹².

The **Romanian** economy continues a dynamic development. The main reasons for the good economic performance refer to construction sector (+33.3%, January-August 2007), and trade (+33.3%). The industry continues to grow, even though at a slower rate. The positive dynamics is registered in the processing industry (+7.1%). Managers expect strong economic performance in September-November in all major sectors of the Romanian economy: industry, constructions, retail trade, and services.

At the same time, there are many risks regarding the Romanian economy. The IMF office in the country warned the Executive from Bucharest about 4 such risks: the rapid growth of the current account deficit, forecasted to reach 14% of GDP until the end of the year; rising public expenses (33% increase of the pension fund), quick rise of salaries in the public sector, which increased much faster than in the

¹² Eurostat, The Economist, RBC, Global Insight Inc.



private sector; and fluctuations on the international financial markets¹³.



¹³ Source: The Financial Week (Săptămâna Financiară), Capital , The Stream (Curentul), The Economist.